Supreme Court, U.S.
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No. 92-1839

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1993

COLGATE-PALMOLIVE COMPANY,
*Petitioner*,

v.

FRANCHISE TAX BOARD,
An Agency Of The State Of California,
*Respondent*.

**On Writ of Certiorari to the Court of Appeal of the State of California In and for the Third Appellate District**

## JOINT APPENDIX

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**PETITION FOR CERTIORARI FILED MAY 19, 1993**
**CERTIORARI GRANTED NOVEMBER 1, 1993**

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**The following opinions have been omitted in printing this joint appendix because they appear on the following pages in the appendix to the printed Petition for Certiorari:**

**Opinion of the California Court of Appeal, Third Appellate District, on Transfer from the California Supreme Court, November 20, 1992 ..... 2a**

**Opinion of the California Court of Appeal, Third Appellate District, August 20, 1991 ..... 29a**

**Decision of the California Superior Court, County of Sacramento, April 19, 1989 ..... 74a**

## CHRONOLOGICAL LIST OF DOCKET ENTRIES

| DATE | PROCEEDINGS |
|---|---|
| April 26, 1984 | Complaint filed in California Superior Court, County of Sacramento. |
| June 7, 1984 | Answer on behalf of Defendant, Franchise Tax Board, filed. |
| July 7-<br>July 26, 1988 | Proceedings before the Honorable Robert Gardner, Judge Pro Tem, California Superior Court. |
| April 19, 1989 | Decision filed by Honorable Robert Gardner, Judge Pro Tem, California Superior Court [text printed in Appendix F to Petition for a Writ of Certiorari (the "Petition") at 74a]. |
| June 15, 1989 | Judgment |
| May 15, 1990 | Appellant Franchise Tax Board's brief filed with California Court of Appeal, Third Appellate District. |
| October 17, 1990 | Respondent Colgate's brief filed with California Court of Appeal, Third Appellate District. |
| Dec. 10, 1990 | Appellant's Reply Brief filed with California Court of Appeal, Third Appellate District. |
| August 20, 1991 | Opinion of the California Court of Appeal, Third Appellate District [text printed in Appendix E to the Petition at 29a]. |
| Sept. 4, 1991 | Respondent Colgate's Petition for Rehearing filed with California Court of Appeal, Third Appellate District. |
| Sept. 11, 1991 | Answer to Respondent's Petition for Rehearing filed with California Court of Appeal, Third Appellate District. |
| Sept. 16, 1991 | Order of California Court of Appeal, Third Appellate District, denying Rehearing. |
| Sept. 30, 1991 | Colgate's Petition for Review filed in the California Supreme Court. |

| DATE | PROCEEDINGS |
|---|---|
| October 21, 1991 | Franchise Tax Board's Answer to Petition for Review filed in the California Supreme Court. |
| October 31, 1991 | Colgate's Reply to the Answer to the Petition for Review filed in the California Supreme Court. |
| Nov. 27, 1991 | Order of the California Supreme Court granting review [text printed in Appendix D to the Petition at 28a]. |
| Feb. 24, 1992 | Colgate's Opening Brief on the Merits filed in the California Supreme Court. |
| June 18, 1992 | Order of the California Supreme Court transferring case to the California Court of Appeal [text printed in Appendix C to the Petition at 27a]. |
| August 31, 1992 | Colgate's Supplemental Brief on transfer from the California Supreme Court filed. |
| August 31, 1992 | Franchise Tax Board's Supplemental Brief on transfer from the California Supreme Court filed. |
| Nov. 20, 1992 | Opinion of the Court of Appeal on transfer [text printed in Appendix B to the Petition at 2a]. |
| Dec. 30, 1992 | Colgate's Petition for Review filed in the California Supreme Court. |
| January 1, 1993 | Franchise Tax Board's Answer to the Petition for Review filed in the California Supreme Court. |
| January 29, 1993 | Colgate's Reply to the Answer to the Petition for Review filed in the California Supreme Court. |
| Feb. 18, 1993 | Order of the California Supreme Court denying review [text printed in Appendix A to the Petition at 1a]. |



SUPERIOR COURT
OF THE STATE OF CALIFORNIA
FOR THE COUNTY OF SACRAMENTO

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No. 319715

COLGATE-PALMOLIVE CO.,
a Delaware Corporation,
*Plaintiff,*

v.

FRANCHISE TAX BOARD,
an Agency of the State of California,
*Defendant.*

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**JOINT STIPULATION**

Trial Date: July 13, 1988
Before Honorable Robert Gardner

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IT IS HEREBY STIPULATED by and between Colgate-Palmolive Company and the Franchise Tax Board, through their attorneys of record, that the following facts are agreed and undisputed. This Stipulation shall not be construed as a concession by either party of the relevancy or materiality of any of the facts stipulated. The parties reserve the right to object to the admission of any document, or group of documents, or any stipulated fact, on any grounds other than those specifically waived in this Stipulation.

All documents referred to herein or specifically enumerated are compiled under separate cover, have been reviewed by counsel for the parties, and their authenticity

is admitted. Pursuant to Evidence Code § 1511, to the extent that the originals of any of these documents are ultimately determined to be admissible, photocopies of these documents will be admissible for purposes of trial in place of the originals.

Nothing contained herein shall be construed as a waiver by any party of its right to review on appeal any question of law or fact arising in this action in the same manner and to the same extent as if the facts set forth herein had been proven in open court.

## FACTS

The following facts are agreed and undisputed:

1. During the income years 1970, 1971, 1972 and 1973, plaintiff Colgate-Palmolive Company was a corporation organized and existing under the laws of Delaware, was headquartered in New York, and was qualified to do, and was doing, business in the State of California. Colgate-Palmolive Company and its subsidiaries doing business in the United States (with the exception of subsidiaries acquired in 1972 and 1973, *i.e.* The Kendall Company and Helena Rubenstein, Inc.) are hereinafter referred to collectively as "Colgate".

2. Colgate timely filed California franchise tax returns for the income years 1970 through 1973. Those returns are designated as Joint Exhibits 2a, 2b, 2c, and 2d, respectively.

3. Upon audit of those returns, the Franchise Tax Board of the State of California ("FTB") issued Notices of Additional Tax Proposed to be Assessed for each of the income years 1970 through 1973. Those notices are designated as Joint Exhibits 3a, 3b, 3c, and 3d, respectively.

4. Plaintiff timely protested the proposed assessments. After consideration of the protest, the FTB issued Notices of Action on Taxpayer's Protest for the income years 1970 through 1973, which are designated as Joint Exhibits 4a, 4b, 4c, and 4d, respectively.



5. Plaintiff also filed with the FTB a petition pursuant to § 25137 of the Revenue & Taxation Code for the income years 1970 through 1973. The transcripts of the hearing before the FTB on that petition is designated as Joint Exhibit 5.

6. After the hearing, the FTB adopted the resolution regarding the § 25137 petition of Colgate which is designated as Joint Exhibit 6.

7. After paying the amounts reflected on the Notices of Action on Taxpayer's Protest, Colgate timely filed claims for refund for the income years 1970 through 1973, which are designated as Joint Exhibits 7a, 7b, 7c and 7d, respectively.

8. During the income years 1970 through 1973, 75 subsidiaries of Colgate operated in 53 foreign countries. The subsidiaries operating in foreign countries are collectively referred to as the "foreign subsidiaries". A list of those subsidiaries, including the city and country in which they are headquartered and the year in which they commenced operations, is designated as Joint Exhibit 8.

. . .

28. The United States Department of Justice and the Government of the United Kingdom have filed briefs *amicus curiae* in the consolidated cases of *Barclay's Bank of California* v. *Franchise Tax Board*, No. 325061 (Sacramento Superior Court) and *Barclay's Bank International, Ltd.* v. *Franchise Tax Board*, No. 325059 (Sacramento Superior Court). The brief *amicus curiae* of the Department of Justice is designated as Joint Exhibit 28a, and the brief of the United Kingdom is designated as Joint Exhibit 28b. The order of the Sacramento Superior Court adopting the intended decision in the consolidated *Barclay's* [sic] cases is designated Joint Ex-

hibit 28c. The FTB's opening appellate brief in the consolidated *Barclay's* case is attached as Joint Exhibit 28d.

. . .

71. If it is ultimately determined in this case that the FTB may not combine Colgate with the foreign subsidiaries in a single, worldwide unitary group, then the taxable income, California apportionment percentage, California business income, total franchise tax, tax previously paid, and amount of refund of tax due to Colgate (not including interest to be computed under Section 26080 of the Revenue and Taxation Code) are as follows:

| Income Year | Taxable Income | California Apportionment Percentage | California Business Income |
|---|---|---|---|
| 1970 | $25,652,055 | 9.31920% | $2,390,566 |
| 1971 | 27,520,141 | 9.01730% | 2,481,574 |
| 1972 | 32,440,358 | 9.21640% | 2,989,833 |
| 1973 | 36,554,062 | 8.88730% | 3,248,669 |

| Income Year | Franchise Tax | Tax Previously Paid | Refund of Tax |
|---|---|---|---|
| 1970 | $167,340 | $ 283,356 | $116,016 |
| 1971 | 173,710 | 311,997 | 138,287 |
| 1972 | 227,227 | 379,529 | 152,302 |
| 1973 | 269,640 | 467,800 | 198,160 |
| TOTAL | $837,917 | $1,442,682 | $604,765 |

. . .

This Stipulation is made this 13th day of July, 1988.

WILLIAM ALSUP
JAMES P. KLEIER
MONIQUE VAN YZERLOOY
MORRISON & FOERSTER

By _____
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Supervising Deputy Attorney General

By _____
JOHN D. SCHELL
Deputy Attorney General
Counsel for Defendant



[In the Superior Court of the State of California
for the County of Sacramento]

**PLAINTIFF'S EXHIBIT 1**

THE WHITE HOUSE
Office of the Press Secretary

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For Immediate Release November 8, 1985

STATEMENT BY THE PRESIDENT

Since early in this Administration, we have been working with the states, the business community, and foreign governments in an effort to resolve issues related to state use of the worldwide unitary method of taxation. At this time I believe it appropriate for the Federal Government to state its support for the concept of legislation that would:

1. Effect a requirement that multinationals be taxed by states only on income derived from the territory of the United States ("the water's edge requirement"); and
2. Address the question of equitable taxation of foreign source dividends.

We hoped that by this time these principles would have been enacted by the various states that have unitary taxation. Since states have not universally accepted these principles, I am instructing the Secretary of the Treasury to initiate the process of crafting Federal legislation to incorporate these principles into law and to work with the Congress for passage, and also, where appropriate, to enter into negotiations to amend double taxation agreements. I am also instructing the Secretary of the Treasury to pursue enactment of the domestic "spreadsheet" legislation, which has been previously proposed,

and which is designed to assist nonunitary states with tax enforcement respecting multinational corporations in order to promote full taxpayer disclosure and accountability.

Further, I am instructing the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases consistent with this approach.

. . .



[In the Superior Court of the State of California
for the County of Sacramento]

**PLAINTIFF'S EXHIBIT 2**

THE SECRETARY OF STATE
Washington

Jan. 30 1986

The Honorable
George Deukmejian,
Governor of California,
Sacramento.

Dear Governor Deukmejian:

As you are aware, federal legislation was recently introduced with the full support of the Administration which would prohibit states from taxing corporations under the worldwide unitary method and from taxing more than an equitable share of foreign source dividends. This action was taken at the express direction of the President. I am writing to explain to you the foreign policy concerns that prompted this legislation and to urge you to act promptly to reconsider your state's use of the worldwide unitary method of taxation.

When a corporation (or related group of corporations) operates across state or national boundaries, competing tax claims of the jurisdictions in which the corporate group operates are resolved by identifying the income attributable to each jurisdiction. Two different methods are in use for making the determination with respect to transnational income: separate accounting and worldwide unitary combination. The longstanding policy of the federal government has been to follow the separate accounting method. The United States has advocated and adopted the position that the "arm's-length" adjustment method of allocating income among commonly controlled corporations doing business in various national jurisdictions is the appropriate method to be employed. This

view is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. It is prescribed in the model income tax treaties published by the Organization for Economic Cooperation and Development ("OECD") and the United Nations ("UN") and by foreign country tax systems generally. In contrast, the worldwide unitary method of taxation is followed only by seven of the U.S. states. Your state's employment of the worldwide unitary method of tax accounting is at odds with the position of the United States and has become a source of conflict with foreign states.

In an environment in which separate accounting is the federal policy and the generally accepted international rule, state taxation on a worldwide unitary basis creates a clear risk of double taxation. Because labor costs and property values vary sharply on an international basis, the rates of profitability of affiliates operating within and without the jurisdiction of the unitary state are often different. Double taxation will result if the relative profitability of the investment in the unitary tax state is less than that of the affiliated overseas operations that are taxed abroad on a separate accounting basis. This risk of double taxation may distort investment decisions, thereby reducing the overall flow of investment into the United States.

Our concern over the worldwide unitary method of taxation's inhibiting effect on foreign investment in the United States is shared by many foreign governments. They have advised us of their view that "The [unitary tax] method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." They contend that the unitary method of taxation constitutes ". . . a serious obstacle to the further development of our trade and investment relationships." (Diplomatic note signed by the Ambassadors of Australia, Belgium, Canada, Denmark, France, Federal Republic of Germany, the United Kingdom, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, and Switzerland.)



The administration of the worldwide unitary method of taxation also imposes unreasonable and costly compliance burdens on an enterprise which is considered to be part of a worldwide unitary group. The information required by the tax authorities of the jurisdiction practicing a worldwide unitary method of taxation may not be readily available to the enterprise and, in the case of foreign-controlled entities which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other reason, will require costly conversion into a form usable by the jurisdiction's tax authority.

For these reasons I believe state worldwide unitary taxation to be inappropriate. Continued state taxation on a worldwide unitary basis will greatly impair the ability of the federal government to carry out its tax and investment policy in the international arena and to manage the sensitive issue of international double taxation. The worldwide unitary issue has seriously complicated our economic relations with many of our closest allies. During my tenure as Secretary of State, this has been a difficult and long-lasting issue. The Department of State has received diplomatic notes complaining about state use of the worldwide unitary method of taxation from virtually every developed country in the world. The unitary issue has been partially responsible for stalling some bilateral tax treaty negotiations.

Most seriously, the U.K. Parliament, in July, 1985, unanimously adopted anti-unitary retaliatory legislation permitting the U.K. government to deny, on a unilateral basis and retroactive to April, 1985, a very valuable benefit of the U.S.-U.K. tax treaty for U.S. corporations operating in worldwide unitary states. This legislation, by virtue of a provision which makes possible the retroactive

imposition of heavy penalties, was having a chilling effect on the willingness of U.S. companies to repatriate earnings of their U.K. subsidiaries to the United States and on their willingness to claim benefits properly available to them under the treaty. While the U.K. has agreed to defer implementation of this legislation for the time being, this incident makes it clear that state worldwide unitary taxation is adversely affecting the United States' foreign economic relations.

While the Administration has proposed federal legislation prohibiting worldwide unitary taxation and limiting state taxation of foreign dividends, I would welcome swift legislative or administrative action by your state to terminate your state's use of the worldwide unitary method of taxation and to limit appropriately your state's taxation of foreign source dividends.

Sincerely yours,

/s/ George P. Shultz
GEORGE P. SHULTZ



[In the Superior Court of the State of California
for the County of Sacramento]

**PLAINTIFF'S EXHIBIT 3**

[LOGO]

THE SECRETARY OF THE TREASURY
Washington

March 5, 1986

Dear Bob:

S. 1974, introduced by Senator Wilson, as well as Senators Mathias and Hawkins, in the Senate on December 18, 1985, would generally prohibit states from levying corporate income taxes on a worldwide unitary basis. This legislation falls within the jurisdiction of the Senate Finance Committee. The bill was drafted by the Treasury Department at the express direction of the President and has the full support of the Administration. I have attached for your consideration a copy of the President's statement of November 8, 1985 on the worldwide unitary tax issue, directing me to prepare and submit this legislation to Congress. A technical explanation of the bill, providing a complete description of its provisions, is also enclosed. This letter is intended to provide you with background on the worldwide unitary tax issue and to describe the serious concerns that have led the Administration to propose and support this legislation.

I. *Description of Current State Corporate Income Tax Practice*

When a corporation (or related group of corporations) operates across state or national boundaries, competing tax claims of the jurisdictions in which the corporate group operates are resolved by identifying the income attributable to each jurisdiction. Two different taxation methods are in use for making this determination: separate accounting and worldwide unitary combination.

Separate accounting is the method of taxation in use generally throughout the world and is employed by the fed-

eral government. Under separate accounting, taxable income is determined separately for each individual corporation. Any improper income or profit shifting between related corporations for tax avoidance purposes is corrected by requiring "arm's length" pricing in related party transactions. That is, flows of goods and services between related or commonly-owned corporations are required to be valued at prices corresponding to those that would govern transactions between unrelated entities operating at arm's length. Under the separate accounting method, double taxation between jurisdictions is relieved either through exemption from tax by the residence jurisdiction (usually the place of incorporation or management control) of income derived in the source jurisdiction (the place the income is earned), or by the residence jurisdiction granting a credit for taxes paid to the source jurisdiction. The United States federal tax law uses the latter approach.

The alternative method, worldwide unitary combination, is currently used by seven states (Alaska, California, Idaho, Montana, New Hampshire, North Dakota, and Utah *) to determine a multinational enterprise's state corporate tax liability. Under this approach, the business income of all individual companies in the commonly controlled enterprise which operate in the same general line of business (the "unitary business") as the corporation or corporations subject to the state's taxing jurisdiction is aggregated, regardless of (i) whether the other individual companies are foreign or domestic; (ii) whether the other individual companies have a tax nexus with or presence in the state in question; and (iii) whether the income of the other individual companies would be treated as derived from foreign or domestic sources under federal

* Utah has adopted administrative rules that would abandon worldwide unitary taxation upon implementation of certain federal assistance measures, including the enactment of the federal assistance legislation contained in the proposed bill and described in section IV, below.



tax rules or generally accepted international taxation principles. A share of the aggregated income of the worldwide unitary group is then assigned or apportioned to the taxing state on the basis of a formula which is intended to measure how much of the activity of the unitary business (and hence its income) is attributable to the taxing jurisdiction.

The apportionment formula generally used is based on relative amounts of payroll, property, and sales. If, for example, 25 percent of the payroll, property, and sales of the unitary group is located in the taxing jurisdiction, then 25 percent of the group's aggregate income from the unitary business would be apportioned to that state. Because the apportionment formula is considered to assign the appropriate amount of income to a particular state, no further measures are taken to relieve any multiple taxation of the same income which may arise from the use of different income sourcing rules by other taxing jurisdictions.

Under the worldwide unitary method, dividends paid by one corporation to another within the unitary business group are eliminated as intercorporate transfers. Under separate accounting, in contrast, intercorporate dividends are recognized explicitly as a flow of income from the dividend-paying corporation to the dividend-receiving corporation. A "water's edge" limitation on the unitary method, i.e., excluding foreign corporations, would respect the separate entity status of related domestic and foreign corporations. It therefore gives rise to the question of how dividends received by a U.S. corporation that is a member of a "water's edge" unitary group from a foreign corporation that is not a member of the "water's edge" group should be treated for state tax purposes. The question of state taxation of foreign-source dividends is thus inextricably linked to the issue of worldwide unitary taxation and, as described below, is therefore addressed in the proposed legislation.

Under present law, state taxation of intercorporate dividends, foreign and domestic, exhibits a range of practice. Though dividends from a domestic corporation are subject to tax in nearly all states with a corporate income tax, most of these states also grant a dividends-received deduction, frequently the 85 percent or 100 percent deduction allowed under federal law. As at the federal level, the effect of this treatment is largely to exempt dividends paid by a domestic corporation from state corporate income taxation. Dividends received from a foreign corporation are subject to varying treatment, ranging from full allocation (and thus taxation) to the recipient's commercial domicile, to apportionment, to either full or partial exemption. Unlike the federal government, no state alleviates international double taxation of foreign dividends by allowing a foreign tax credit.

## II. *Reasons for Administration Opposition to Worldwide Unitary Taxation*

It has been the longstanding policy of the United States to favor the separate accounting method for allocating income among nations for purposes of taxation. This policy is embodied in the Internal Revenue Code and is a central feature in our bilateral tax treaties. Separate accounting is also the international standard. The model tax treaties published by the Organization for Economic Cooperation and Development ("OECD") and the United Nations ("UN") specify that transnational income is to be taxed on a separate accounting basis. Thus, continued state worldwide unitary taxation is directly in conflict with federal and internationally accepted practice and impedes the ability of the federal government to pursue this policy in its international dealings.

During the debate over worldwide unitary taxation, foreign governments have repeatedly petitioned the federal government to act to curb state use of the worldwide unitary method. Diplomatic notes articulating the problems



caused by state worldwide unitary taxation have been received from virtually every developed country in the world, including Canada, the United Kingdom, Germany, France, Belgium, the Netherlands, Italy, Switzerland, Japan, and Australia. The United Kingdom, in July, 1985, adopted anti-unitary retaliatory legislation that would permit the U.K. government to effectively increase the U.K. tax on dividend distributions from U.K. subsidiaries to their U.S. parent corporations operating in worldwide unitary states. If implemented, this legislation would clearly violate the U.S.-U.K. bilateral income tax treaty. This legislation, by virtue of a provision which makes possible the retroactive imposition of heavy penalties, was having an adverse effect on the willingness of U.S. companies to repatriate earnings of their U.K. subsidiaries to the United States. (The U.K. has now agreed to defer implementation of this legislation for the time being.) The adoption of this legislation by the U.K. illustrates that state worldwide unitary taxation is clearly adversely affecting the United States' foreign economic relations.

Foreign governments and businesses that are subject to worldwide unitary taxation argue that this method of computing state tax gives rise to double taxation of foreign income. They also contend that worldwide unitary taxation is administratively burdensome, particularly for foreign owned companies. These results are inevitable as long as a few states rely on a method of measuring income that is different from the approach used by the rest of the world.

Theoretically, if all jurisdictions, domestic and foreign, were to adopt a uniform unitary method of taxation, and apply it consistently, there would be no double taxation as the formula would not apportion the same income to more than one jurisdiction. The problem, however, arises from the fact that combined reporting on a worldwide unitary basis is a distinctly minority practice. In an en-

vironment in which separate accounting is the generally accepted rule, state taxation on a worldwide unitary basis creates a clear risk of double taxation. Because labor costs, property values, and profitability can vary greatly among countries, an income measurement system based on formula apportionment is in open conflict with the international standard of separate accounting. This is because formula apportionment assumes all parts of a unitary business are equally profitable whereas separate accounting acknowledges that individual corporations can earn different rates of return. Double taxation will result if the relative profitability of the investment in the unitary tax state is less than that of the affiliated overseas operations that are taxed abroad on a separate accounting basis.

State use of the worldwide unitary method also creates administrative burdens for taxpayers. There are substantial costs associated with collecting and converting accounting data generated by the various foreign affiliates of the unitary group to a form consistent with U.S. standards. These burdens can be particularly acute for foreign-owned companies which are not required to keep data under U.S. tax and financial accounting rules on their non-U.S. operations for any other purpose.

The use of the worldwide unitary method by some states may also inhibit and distort the international flow of investment capital. In the words of one foreign government, "[t]he [unitary tax] method can chill international investment and decrease efficient allocation of resources and employment opportunities. In particular, the unitary method can impede foreign entry into the United States market." Consequently, according to a group of foreign governments, worldwide unitary tax constitutes ". . . a serious obstacle to the further development of our trade and investment relationships." (Note signed by the Ambassadors of fourteen of our major trading partners). The United States is strongly committed to encouraging



the free movement of international direct investment capital across national boundaries. State use of the worldwide unitary method is unacceptable because it can adversely affect this clearly articulated federal policy. The United States, as the country hosting the largest amount of foreign direct investment, has gained enormously from the inflow of foreign investment. If the use by some of our states of the worldwide unitary method inhibits the flow of capital, the economic well-being of the country as a whole would suffer. Some states may be in a position in which their use of the unitary method causes foreign investors to turn away from the United States altogether (rather than shift investments to other U.S. states).

In September 1983, in response to complaints raised by both the U.S. and foreign business community and foreign governments over the Supreme Court decision in *Container Corp.* v. *Franchise Tax Board*, President Reagan asked then Treasury Secretary Donald Regan to establish and chair a Worldwide Unitary Taxation Working Group. This group was composed of representatives of the federal government, state governments, and the business community and was asked to provide recommendations suitable for resolving the issues raised by worldwide unitary taxation.

At its final meeting on May 1, 1984, the Worldwide Unitary Taxation Working Group agreed on three principles that should guide state taxation of the income of multinational corporations:

Principle 1:

> "Water's edge" unitary combination for both U.S.- and foreign-based companies.

Principle 2:

> Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability.

Principle 3:

> Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses.

While the first and third principles were to be adopted voluntarily on a state-by-state basis, Principle 1, in particular, represented a clear recognition by the Working Group that the separate accounting method was superior to the worldwide unitary method in the international context. The Administration was very hopeful that the states would be able to resolve the worldwide unitary problem along the lines advocated by the Working Group on a voluntary basis without resort to federal legislative intervention.

Since the adoption of the Working Group Report some states have changed their laws to conform to the Working Group principles. Florida, Colorado, Indiana and Oregon have ceased taxing on a worldwide unitary basis. A Massachusetts court decision imposed limitations on that state's use of the worldwide unitary method and the state legislature has to date refrained from taking any action that would permit application of that method in the face of the judicial decision. However, seven other states continue to use the worldwide unitary method. In particular, efforts in California to enact legislation limiting worldwide unitary taxation have foundered in the past two legislative sessions, most recently when the California legislature adjourned for the year in September, 1985 without taking action on the issue.

In transmitting the report of the Working Group to the President, Secretary Regan indicated that he would recommend restrictive federal legislation if substantial voluntary progress had not been made on the worldwide unitary issue at the state level by July 31, 1985. That date has long since passed. We now believe that the time has come for Congress to act to finally resolve this serious international economic problem.



## III. *State Taxation of Foreign-Source Dividends*

The taxation of foreign-source dividends is directly related to the issue of worldwide unitary taxation. A limited resolution of the worldwide unitary issue—such as an agreement by states not to impose worldwide unitary tax but with no restriction on the taxation of foreign-source intercorporate dividends—would cause other serious problems. In effect, this would be a "foreign only" situation, freeing foreign-owned multinationals from the yoke of worldwide unitary taxation while subjecting U.S. based multinationals to full taxation on their foreign dividend income. Such a "foreign only" solution, if adopted, would disadvantage domestically controlled businesses. The Working Group's third principle recognizes the need for competitive balance for domestic multinationals, foreign multinationals, and purely domestic businesses. That principle requires that legislation restricting state unitary taxation also address the question of equitable state taxation of foreign-source dividends. Unrelieved state taxation of foreign dividends is not consistent with Principle 3.

Unrestricted state taxation of foreign dividends would subject domestic businesses to serious double taxation of foreign income. Federal tax policy has long been characterized by its commitment to avoid international double taxation. Indeed, the United States has been a leader in a worldwide effort to establish taxing rules under treaties and commonly accepted principles that minimize international double taxation. If a clear federal policy is not to be undercut by state action, states must comply with this policy of eliminating double taxation and therefore be limited to taxing some equitable portion of foreign source dividends.

The legislation does not mandate that any specific method of dividend taxation be imposed on the states. In our view, arguments of state fiscal sovereignty strongly indicate that states should have leeway to tailor their own

systems of taxation to the extent that they do not cause serious foreign commerce difficulties by resulting in systematic overtaxation and double taxation of U.S. business in contravention of established federal and international policy. The legislation therefore provides in broad terms for the equitable taxation of dividends and suggests certain guidelines that states could follow in satisfying that standard. As an illustration of the flexibility of the approach, the legislation would accept as appropriate the treatment of dividends in such states as Colorado, Oregon, Florida and Illinois, states which have been intimately involved in the worldwide unitary tax controversy.

IV. *Information Reporting and Other Federal Assistance*

States have legitimately contended in the Working Group and elsewhere that they lack the resources and ability to monitor adequately transactions between members of a water's edge unitary group and related foreign companies outside that group. The Treasury Department agreed with recommendations of the Working Group to provide appropriate federal assistance to the states in order to assure proper working of the separate accounting method. The Working Group suggested that an annual information return be filed with the Internal Revenue Service by multinational companies. This return would in turn be shared with the states and with multistate audit agencies and would provide states with some assurance that corporations had allocated and apportioned the appropriate share of the corporation's income to each state. The report would also identify those related companies with which serious income shifting would be most likely to arise. In the summer of 1985, the Treasury Department published for comment a draft of legislation implementing this reporting system. Section 3 of the bill is based upon that draft after taking into account the many comments received from affected businesses and the various states. We believe that the information reporting system provided for in the bill is an integral part of the solution to the worldwide unitary problem.



In order to provide states with greater assistance the Treasury Department also indicated in the Working Group an intention to increase the resources devoted to the IRS's administration of tax laws applicable to foreign operations of multinational companies. I urge your assistance in approving the increased budget appropriations that are being requested for this purpose.

*Conclusion*

I strongly urge the prompt and favorable consideration of this legislation by the Finance Committee. The serious foreign commerce difficulties caused by the use of the worldwide unitary tax method by a few states must now be resolved.

OMB has advised that there is no objection from the standpoint of the Administration's program to the presentation of this legislation to the Congress and that its enactment would be in accord with the program of the President.

Sincerely,

/s/ Jim
JAMES A. BAKER, III

The Honorable Bob Packwood
Chairman, Finance Committee
United States Senate
Washington, D.C. 20510

(Attachments omitted in printing)

[In the Superior Court of the State of California
for the County of Sacramento]

**JOINT EXHIBIT 34b**

DEPARTMENT OF THE TREASURY
Washington

[LOGO]

Assistant Secretary

Dear Governor Deukmejian:

The Department of the Treasury recently received and studied with interest the Franchise Tax Board's "Report to the Legislature on 80-20 Corporations, As Mandated by Senate Bill 85, Section 14 (Stats. 1986, Ch. 660)". There are two issues addressed in the Report which we feel compelled to comment upon. These issues deal with Internal Revenue Service audits of federal consolidated returns and the Administration's desire for equitable state tax treatment of foreign and domestic corporations. We hope that you will take these comments into consideration in developing legislation to address the "80-20" issue.

*The IRS Audit Issue*

The first issue involves Internal Revenue Service audits of 80-20 corporations. The Report asserts that "[an Internal Revenue Code section 861] sourcing audit need not, and does not, include examination of potential shifting of income between entities" of a federal consolidated filing group. Although it is accurate to say that it does not matter for many federal purposes which member of the group has the foreign source income, section 482 arm's-length pricing adjustments are used to prevent the shifting of income within the group from U.S. to foreign sources.

In auditing Federal consolidated returns, section 482 arm's-length pricing principles are used not only to audit transactions between the consolidated return group and



other entities, but also to audit transactions within the group in order to determine the foreign source income of the consolidated group. That is, when a member of a consolidated group asserts that it has derived foreign source income from a transaction with another group member, section 861 is used to determine whether the income is foreign source and section 482 is used to allocate income from that transaction using arm's length pricing principles. Furthermore, in the future, these intra-group section 482 pricing audits will be used even more extensively in light of the tremendous pressure which the Tax Reform Act of 1986 has put on correct calculation of the foreign tax credit limitation. For these reasons, we feel that California can place reliance upon the Internal Revenue Service to determine the foreign source income of any 80-20 corporations included in a federal consolidated return.

*The Equity Issue*

In developing good tax policy, the principle that taxpayers in similar situations should face similar tax burdens should be followed unless there are overwhelming reasons to the contrary. The "equity issue" in the 80-20 corporation debate is based on this principle. For taxpayers electing "water's edge" treatment under the Senate Bill 85 (Stats. 1986, Ch. 660), foreign corporations with more than 80 percent of their business activity outside the United States are excluded from unitary combined income subject to apportionment and taxation in California. However, the new statute specifically includes domestic corporations, otherwise in the identical circumstances, within the water's edge combination.

While recognizing that there may be revenue or administrative reasons for different tax regimes for foreign subsidiaries and 80-20 corporations, we feel that the Franchise Tax Board Report fails to address adequately the policy considerations underlying the equity issue. Although the Report correctly points out that this issue in-

volves a judgmental determination, rather than a factual question, the Report, in our view, fails to provide any basis for a rational policy distinction.

For example, the Report merely advances as a counter-argument that there are separate tax structures for corporations, individuals, and partnerships and that there are different federal tax treatments of domestic and foreign corporations. In doing so, however, the Report fails to point out that the different tax structures of corporations, individuals, and partnerships are based upon substantial differences in form and that federal taxation of domestic corporations is on a residence basis, taxing worldwide income, while taxation of foreign corporations is based on a source and business activity basis, taxing certain U.S. source income and all income from both U.S. and non-U.S. sources that is effectively connected with a foreign corporation's U.S. trade or business.

The Report further asserts, without example or analysis, that taxation of 80/20 corporations on an apportionment basis does not appear to be competitively disadvantageous in comparison to controlled foreign corporations which face taxation of 25 percent of repatriated dividends on an allocation basis. That is, the report simply states that, because the taxpayers in question might end up facing similar tax burdens, the principle of equity is satisfied. We fail to see how this simple assertion that the tax burdens between domestic and foreign corporations under California law might, by coincidence, be comparable can excuse a policy of subjecting them to different tax structures.

We encourage you to analyze more fully the policy considerations underlying the equity issue. We hope that, when you do so, you will agree 1) that when water's edge unitary combinations are defined on the basis of business activity, place of incorporation should be irrelevant; 2) that there is no valid policy justification for California's subjecting two taxpayers, for example, one with a Delaware subsidiary operating primarily abroad,



the other whose foreign operations are conducted through a French subsidiary, to different tax regimes; and 3) that in this era of trade competitiveness, the potential for inflicting higher tax burdens on corporations with 80-20 operations, as opposed to foreign subsidiary operations, should be avoided.

In summary, we feel that the Report misrepresents what we regard as adequate section 482 audit coverage by the IRS of foreign source income reported on consolidated returns and that the Report fails to examine the policy concerns underlying the equity issue. We would remind you that we identified California's treatment of 80-20 corporations as an element of federal concern in testimony last September on S.1974, legislation which would impose federal restrictions on state's use of the unitary combination method of corporate taxation. In that testimony, the Administration stated that "we do not recommend adoption of restrictive federal legislation at this time. [However,] We believe further progress is required to address the concerns we have raised and, if such progress is not forthcoming within a reasonable time frame, we may recommend reconsideration of the legislation in the future". While we would greatly prefer a state solution to the unitary issue, the Administration will accept such a solution only if it fairly deals with the important issues delineated in our testimony, which include the 80-20 issue. I therefore urge you to search for an answer to this issue beyond the Franchise Tax Board's Report.

Sincerely,

/s/ J. Roger Mentz
J. ROGER MENTZ
Assistant Secretary
(Tax Policy)

The Honorable George Deukmejian
Governor of the State of California
State Capitol
Sacramento, California 95814

[In the Superior Court of the State of California
for the County of Sacramento]

**JOINT EXHIBIT 64**

[LOGO]

U.S. DEPARTMENT OF JUSTICE
Tax Division

Assistant Attorney General

Washington, D.C. 20530
January 27, 1988

William H. Alsup, Esquire
Morrison & Foerster
345 California Street
San Francisco, California 94104-2105

Re: Colgate-Palmolive Co. v. Franchise Tax Board, California Superior Court, Sacramento County No. 319715

Dear Mr. Alsup:

Pursuant to your request, this is to confirm that the statements contained in the December 19, 1986, letter to Mr. Franklin C. Latcham from my predecessor, Assistant Attorney General Roger M. Olsen, a copy of which is attached, continue to reflect the position of the Government.

Sincerely yours,

/s/ William S. Rose, Jr.
WILLIAM S. ROSE, JR.
Assistant Attorney General
Tax Division

Enclosure



[Attachment to Joint Exhibit 64]

[LOGO]

U.S. DEPARTMENT OF JUSTICE
Tax Division

Assistant Attorney General

Washington, D.C. 20530
December 19, 1986

Mr. Franklin C. Latcham
Morrison & Foerster
California Center
345 California Street
San Francisco, California 94104-2105

Re: Colgate Palmolive Co. v. Franchise Tax Board
(Cal. Superior Ct. Sacramento County
No. 319715

Dear Mr. Latcham:

This letter is in response to your request concerning the position taken by the United States in *Barclays Bank of California* v. *Franchise Tax Board,* Civil No. 325061, and *Barclays Bank International, Ltd.* v. *Franchise Tax Board,* Civil No. 325059, pending before the Superior Court of the State of California for Sacramento County, and in *Alcan Aluminum* v. *The Franchise Tax Board of the State of California,* Civil No. 84-C-6932, and *Imperial Chemical Industries PLC* v. *Franchise Tax Board of the State of California,* Civil No. 84-C-8906, pending before the United States District Court for the Northern District of Illinois, Eastern Division. Those cases involved the appropriateness of taxation of the plaintiffs on a worldwide unitary basis under California law prior to the September, 1986, amendment thereto.

In those cases the United States filed briefs amicus curiae wherein it stated its position on the above-stated issue. Enclosed herein are true copies of those amicus

briefs. As you will note, I appeared as counsel of record for the United States on those briefs. Please be advised that the Department of Justice has not been advised of any change in the position of the United States as set forth in those briefs.

Sincerely yours,

/s/ Roger M. Olsen
ROGER M. OLSEN
Assistant Attorney General
Tax Division

Enclosures



[Attached to the Franchise Tax Board's Answer to the First Petition for Review]

**LETTER FROM REUBEN MARK**

August 16, 1991

Honorable Nicholas F. Brady
Secretary of the Treasury
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Secretary Brady:

Your assistance is urgently required to prevent the federal government from inadvertently discriminating against American companies in favor of foreign companies. The federal government has been vigorously assisting foreign companies in upholding the federal policy against worldwide unitary taxation by the states, but has failed to provide the same assistance to American companies. It is now critical for the Department of the Treasury to go on record that this policy equally protects American companies, in order to avoid putting our nation at a severe disadvantage in the highly competitive world of foreign trade.

In a November 8, 1985 statement, President Reagan set forth the Executive Branch's policy opposing the worldwide unitary method of taxation. In that statement, he instructed the Secretary of Treasury to pursue legislation codifying this federal policy.

Recently, the California Court of Appeal ruled in Barclays Bank International Ltd. v. Franchise Tax Board, that worldwide unitary method is unconstitutional as applied to foreign-based multinationals. The court held that the worldwide unitary method interfered with U.S. foreign policy, as clearly expressed by the Executive

Branch. The court based this conclusion largely on the fact that the Department of Justice appeared before the court and filed an amicus brief expressing the federal government's policy.

Colgate is also litigating the constitutionality of the worldwide unitary method as it applies to U.S.-based multinational groups. Oral argument before the California Court of Appeal was recently heard. In contrast to the Barclays case, the Department of Justice neither appeared before the court nor filed an amicus brief.

The application of worldwide unitary taxation to U.S.-based multinationals, but not to foreign-based multinationals, would cede a tremendous advantage to the latter group. The worldwide unitary method assigns income to a particular state by comparing the unitary group's property, payroll and sales in the state with similar worldwide amounts. Because of higher wages and property values in the United States, the amount of income assigned to the state is artificially inflated. If this method is applied to U.S.-based multinationals, but not to foreign-based multinationals, then U.S. parent groups will pay substantially higher taxes on non-U.S. earnings than their foreign competitors, even if the only difference between the two is the place of the parent company's incorporation. In the highly competitive foreign trade area, we can not allow this to occur.

Additionally, the unitary method punishes U.S. companies which manufacture in the U.S. and export, rather than produce overseas. Companies such as Colgate which have significant exports but no imports are punished the most severely. This punishment through higher state taxes occurs in two ways. First, due to the mechanics of the unitary tax formula, employment of U.S. workers and investment in U.S. property raise state taxes. Secondly, higher U.S. wages and property values artificially raise state taxes a second time.

Foreign governments have been extremely active in voicing their opposition to the application of unitary taxation to their companies. Indeed, retaliatory foreign (U.K.) legislation would punish foreign affiliates of U.S. companies. The U.S. stands alone in allowing its companies to suffer this unfair foreign trade disadvantage.



It is now time for U.S. government to stand up and defend the right of American companies to a level playing field. This can only happen if the Executive Branch makes its opposition to unitary taxation of U.S.-based multinationals as explicit as it has its opposition to unitary taxation of foreign groups.

At oral argument in the Colgate case, the judges indicated that Colgate would lose because the Department of Justice neither appeared before the court nor filed an amicus brief explicitly supporting U.S.-based multinationals. The Court of Appeal appeared to view the absence of the Department of Justice or an amicus brief as decisive, notwithstanding the fact that, throughout the long history of federal opposition to worldwide unitary taxation, not one single indicia of this federal opposition has ever distinguished between U.S.-based and foreign-based multinationals. Indeed, it is preposterous to believe that the federal government would intend to discriminate against U.S.-based multinationals based solely upon the fact that the parent corporation is American.

American companies need and are entitled to the same support as the Executive Branch has provided to foreign companies such as Barclays. We are therefore urging the Executive Branch to announce explicitly that the federal policy against worldwide unitary taxation applies to U.S.-based multinationals. This announcement could be issued in any number of forms. We believe that the most effective means of communicating this federal policy would be the filing of an amicus brief in the Colgate case. Under the apparent view of the Court of Appeal, if this federal policy is not made explicit, worldwide unitary taxation will be unfairly applied solely to U.S-based multinationals.

Unfortunately, due to California's procedural rules, we have very little time in which to receive help from the federal government. Thus, if we are to prevent unfair discrimination against American companies, we would appreciate your assistance in convincing the Executive Branch to take prompt action.

If you would like further information or wish to discuss this matter, please telephone Steven Belasco, Vice President, Taxation at (212) 310-3032.

Thank you for your careful consideration of this matter.

Sincerely,

REUBEN MARK
Chairman, President and Chief
Executive Officer
Colgate-Palmolive Company
New York, New York



[Attached to Colgate's First Petition for Review
to the California Supreme Court]

**LETTER FROM SECRETARY OF THE TREASURY**

[LOGO]

THE SECRETARY OF THE TREASURY
Washington

September 13, 1991

Mr. Reuben Mark
Chairman, President and
Chief Executive Officer
Colgate-Palmolive Company
300 Park Avenue
New York, New York 10022

Dear Reuben:

Thank you for your letter of August 16 urging the United States to file an *amicus* brief or to make a policy statement to aid you in Colgate's litigation in California state courts regarding the constitutionality of the worldwide unitary method of taxation as it applies to U.S.-parent multinational corporations. I understand that you wrote similar letters to the Secretary of State, the U.S. Trade Representative, and the Acting Attorney General and that they are responding by referencing this letter so that you will receive a coordinated reply.

As a tax policy matter, we are equally opposed to the use of worldwide unitary apportionment to determine the income of domestic-parent multinational corporations and that of foreign-parent multinational corporations. Treasury has testified before Congress that treaty-based limitations on worldwide unitary apportionment are "the least desirable of possible alternatives" (i.e., state or federal legislation) precisely because they would benefit foreign-

parent multinationals but not domestic-parent multinationals and thus not "satisfy the principle of ensuring competitive balance among similarly situated businesses." (*Cf.* Testimony of J. Roger Mentz, Treasury Assistant Secretary (Tax Policy), before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee, September 29, 1986, page 3.) Our position has not changed.

We will continue to consult with the Departments of Justice and State regarding this issue and will promptly inform you if a decision is made to provide additional assistance. In the meantime, given the deadlines of your present litigation, I enclose for your use correspondence between former Governor Deukmejian and me and between the European Community representative and then-Acting Secretary Robson that outline our continuing opposition to California's use of worldwide unitary apportionment.

Sincerely,

/s/ Nick Brady

Enclosures



[Attachment to Secretary Brady's Letter at J.A. 35]

[LOGO]

THE SECRETARY OF THE TREASURY
Washington

August 23, 1989

The Honorable Lorenzo Gonzalez-Alonso
Minister for Economic and Commercial Affairs
Embassy of Spain
2558 Massachusetts Ave., N.W.
Washington, D.C. 20008-2865

Dear Mr. Gonzalez-Alonso:

Thank you for your letter of June 30, 1989, enclosing a copy of the letter of the same date from Ambassador Santamaria (on behalf of the Member States of the European Community) to Secretary of State James A. Baker III.

The issue of unitary taxation remains a serious concern to the Treasury Department and, indeed, to the Administration of President Bush. Although I do not want to comment on any particular matter of pending litigation, such as the case cited in Ambassador Santamaria's letter, I want to assure you of our continuing attention to this issue. We believe that states' use of the worldwide unitary tax method may constitute an impermissible interference in the conduct of the nation's foreign affairs, and further progress is required before Federal concerns on this issue can be put to rest.

Thus, we continue to endorse strongly the position taken by the prior Administration under which President Reagan instructed the Attorney General to ensure that the United States' interests are represented in appropriate

controversies and cases. We expect the Federal Government to continue to express its views on this matter when and where it is necessary and appropriate to do so.

Sincerely,

/s/ John E. Robson
JOHN E. ROBSON
Acting Secretary



[Attachment to Secretary Brady's Letter at J.A. 35]

Commercial Office
2559 Massachusetts Avenue, N.W.
Washington, D.C. 20008-2865
TEL. (202) 265-8600-01-02
TELEX: 64226 OFCOM UW
FAX: (202) 265-9478

[LOGO]

EMBASSY OF SPAIN
WASHINGTON, D.C.

IN REPLYING PLEASE REFER TO NO. 951-LGA/mv.

June 30th, 1989

The Honorable
Nicholas F. Brady
Secretary of the Treasury
U.S. Department of the Treasury
Washington, D.C. 20220

Dear Sir:

I have the pleasure to enclose herewith a photocopy of the letter that the Ambassador of Spain has forwarded today, on behalf of the Member States of the European Community, to the Secretary of State, The Honorable James A. Baker, III, with respect to their opposition to the use of worldwide unitary tax by the State of California.

Sincerely,

/s/ Lorenzo González-Alonso
LORENZO GONZALEZ-ALONSO
Minister for Economic and
Commercial Affairs.

Enclosure.

[Attachment to Secretary Brady's Letter at J.A. 35]

[LOGO]

*El Embajador de España*

Washington, D.C., June 30th, 1989

The Honorable
James A. Baker, III
Secretary of State
U.S. Department of State
Washington, D.C. 20520

Dear Sir:

The Member States of the European Community have noted that the United States Supreme Court is shortly to hear an appeal against the judgement of the Seventh Circuit Court of Appeals in Imperial Chemical Industries plc and Alcan Aluminium Limited v. California Franchise Tax Board.

The EC Member States consider this to be an appropriate opportunity to restate their opposition to the use of worldwide unitary tax by the State of California. They would urge the United States Government to confirm that, like the previous Administration they, too, are opposed to the use of worldwide unitary tax.

The views of the EC Member States on worldwide unitary tax are well known.* They consider that the imposition of this tax is inconsistent with the internationally accepted principles underlying the Tax Treaties and Friendship Treaties that individual Member States have entered into with the United States. Specifically, the use of the tax by the State of California:

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* Demarche of the EC Member States submitted to the U.S. Department of State: 19 March, 1980; 30 October, 1981; 29 June, 1982; 1 August, 1983; 23 September, 1983; 20 December, 1984; 8 August, 1985; 30 August, 1985.



i) contradicts the "arm's length" principal [sic] of allocating income of multi-national corporations between different national jurisdictions;

ii) may give rise to substantial double taxation;

iii) imposes a severe compliance burden by insisting on the restatement of accounts of different, but affiliated, corporations throughout the world even when they are not doing any business in California—accounts which were originally prepared to meet the specifications of the countries in which these corporations are resident;

iv) has perverse effects on the worldwide strategy of multi-national corporations (since, for example, a cost saving investment made in any country outside the U.S., can increase the tax liability in California, even if the California subsidiary is loss-making);

v) discriminates against companies doing business in California with subsidiaries, rather than through non-affiliated companies.

The EC Member States are strongly opposed to the attempt by California or any other State to impose taxation in [sic] income of foreign corporations arising outside the U.S.; to interfere with worldwide investment strategies, and to insist on burdensome compliance requirements on companies located outside the U.S.

EC Member States are aware that California has amended its legislation to allow multi-national companies to elect, on payment of a fee, to be taxed on a "water's edge", rather than worldwide unitary basis. However, since they are opposed to the use of worldwide unitary tax in principle, Member States cannot accept that it is right to insist on a fee as the price for electing to avoid worldwide unitary tax. Moreover, the process of making such an election involve substantial and unreasonable burdensome compliance costs.

The EC Member States, of course, support the case submitted by Imperial Chemical Industries and by Alcan Aluminium in the District Court and the Seventh Circuit Court of Appeal. They also very much endorse the *amicus* brief submitted by the U.S. in the District Court in ICI and Alcan v. California FTB. The EC Member States are aware that the issue currently before the Supreme Court is the question of the standing of the foreign parent companies to challenge the tax in the Federal courts, rather than the constitutionality of the tax itself. However, they believe the two issues to be inextricably interlinked. The EC Member States consider that worldwide unitary tax imposes an administrative and economic burden on foreign parent corporations and breaches the arm's length standard. Since the U.S. in its double taxation convention adheres to the internationally accepted arm's length principle, application of worldwide unitary tax by separate states of the U.S. prevents the U.S. from speaking with one voice when regulating commercial relations with foreign governments, and in the opinion of EC Member States is unconstitutional. The administrative and economic burden is imposed directly on foreign corporate parents and it is this constitutionally significant burden which creates standing for those foreign parents.

The Member States note and appreciate the U.S. Government's opposition to worldwide unitary tax. Given the importance of the present case before the Supreme Court, the Member States would urge the U.S. Government to reaffirm their commitment to the position taken by the previous Administration.

Sincerely,

/s/ Julian Santamaria
JULIAN SANTAMARIA
Ambassador of Spain



[Attachment to Secretary Brady's Letter at J.A. 35]

[LOGO]

THE SECRETARY OF THE TREASURY
Washington

August 3, 1989

The Honorable George Deukmejian
Governor of California
Sacramento, California 95814

Dear Governor Deukmejian:

I am writing in response to your letter of May 9, 1989, in which you expressed concern over continuing involvement of the Federal Government in state tax matters, specifically referring to the Justice Department's intervention in cases contesting California's use of worldwide unitary apportionment.

This Administration has given the issues raised in your letter serious consideration. We appreciate the substantial progress California has made in recent years in addressing the problems created for taxpayers by the use of worldwide unitary apportionment. Indeed, the Executive Branch's support of Federal water's-edge legislation has been withdrawn for the time being partly in recognition of that progress.

However, problems persist with our trading partners over states' use of the unitary method. Because of this issue's continuing international implications, it is not exclusively a state tax issue. We believe that states' use of the worldwide unitary tax method may constitute an impermissible interference in the conduct of the nation's foreign affairs, and further progress is required before Federal concerns on this issue can be put to rest.

Thus, we continue to endorse strongly the position taken by the prior Administration under which President

Reagan instructed the Attorney General to ensure that the United States' interests are represented in appropriate controversies and cases. Accordingly, this Administration supports the position taken in the United States' *amicus curiae* briefs filed in cases such as *Barclays Bank International, Ltd.* v. *Franchise Tax Board,* 3 Civ. C003388 and 3 Civ. C003389, Ct. App., 3rd App. Dis. We expect the Federal Government to continue to express its views on this matter when and where it is necessary and appropriate to do so. We hope, of course, that such intervention will not be necessary often.

Sincerely,

/s/ Nicholas F. Brady
NICHOLAS F. BRADY



[Attachment to Secretary Brady's Letter at J.A. 35]

OFFICE OF THE ATTORNEY GENERAL
Washington, D.C. 20530

[LOGO]

July 16, 1989

The Honorable George Deukmejian
Governor, State of California
Sacramento, California 95814

Dear George:

I wish to acknowledge your letter of May 9, 1989, in which you expressed concern over the Federal Government's participation in cases involving the constitutionality of the unitary tax method in determining the income tax liability of corporations doing business in the State of California.

The issue is an important one which affects not only the Department of Justice but the Departments of State and Treasury as well. I expect that Treasury Secretary Brady will be responding to you on behalf of the Administration in several days.

Sincerely,

/s/ Dick Thornburgh
DICK THORNBURGH
Attorney General

bcc: Nicholas F. Brady

[Attachment to Secretary Brady's Letter at J.A. 35]

STATE OF CALIFORNIA

[LOGO]

May 9, 1989

The Honorable Nicholas Brady
Secretary of Treasury
United States Department of Treasury
1500 Pennsylvania Avenue, N.W., Room 3330
Washington, D.C. 20220

Dear Mr. Brady:

The purpose of this letter is to express my concern over the continuing involvement of the federal government in state tax matters. During the prior administration, California worked very closely with the federal government and other states in an effort to respond to concerns of our foreign trading partners about the states' use of the worldwide unitary method of taxation. While the states and the federal government both recognized unitary as being pre-eminently a state tax issue, involvement of the federal government was deemed essential because of the issue's clear international implications.

To address this issue, the Federal Working Group on Unitary Taxation was formed in 1983 under then Secretary of Treasury Donald Regan. The Working Group, despite lively debate and negotiation, failed to arrive at a consensus agreement. An understanding, however, was reached on two critical elements: (1) the federal government would provide assistance to states modifying their methods of taxing multinationals; and (2) every state, particularly California, would seek legislation responsive to the concerns of our foreign trading partners.

In 1986 and 1988 I signed legislation that largely addressed these concerns on a prospective basis. Unfortunately, the federal government has not fully delivered its promised assistance.



We now find, in spite of positive action by the states, an expansion of unprecedented federal involvement in state tax issues. The Justice Department participated directly through the filing in September 1988 of an amicus curiae brief with the California Court of Appeal in *Barclays Bank International* v. *Franchise Tax Board* and indirectly by writing letters to plaintiff's counsel in *Colgate-Palmolive Co.* v. *Franchise Tax Board*.

The brief and letters of the prior administration are behind us. I am concerned, however, that the federal government may persist in testing the fragile bonds of federalism, and I respectfully request that the Department of Treasury cease further involvement in these state tax matters.

Thank you for your consideration of these matters.

Most cordially,

/s/ George
GEORGE DEUKMEJIAN

jw

[Attached to Colgate's Reply to the Answer to the First Petition for Review to the California Supreme Court]

DEPARTMENT OF THE TREASURY
Washington

[LOGO]

Assistant Secretary

Mr. Mark S. Cahoon
Executive Director
Committee on State Taxation
122 C St. N.W., Suite 330
Washington, D.C. 20001

Dear Mr. Cahoon:

Thank you for your letter of August 26 regarding worldwide unitary taxation. Secretary Brady asked me to respond to your letter because it concerns an issue of tax policy.

As a tax policy matter, we are equally opposed to the use of worldwide unitary apportionment to determine the income of domestic-parent multinational corporations and that of foreign-parent multinational corporations. The Treasury Department has testified before Congress that treaty-based limitations on unitary worldwide apportionment are "the least desirable of possible alternatives" (i.e., state or federal legislation) precisely because they would benefit foreign-parent multinationals but not domestic-parent multinationals and thus not "satisfy the principle of ensuring competitive balance among similarly situated businesses." (Cf. Testimony of J. Roger Mentz, Treasury Assistant Secretary (Tax Policy), before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee, September 29, 1986, page 3.) Our position has not changed.

We continue to follow this matter with great interest. We are consulting with the Departments of Justice and State, and we will take action when it appears appropriate.



Thank you for your interest in this matter.

Sincerely,

/s/ Kenneth W. Gideon
KENNETH W. GIDEON
Assistant Secretary
(Tax Policy)

[Attached to Colgate's Opening Brief on the Merits in the California Supreme Court]

DEPARTMENT OF THE TREASURY
Washington

[LOGO]

Assistant Secretary

Mr. Jerry J. Jasinowski
President
National Association of Manufacturers
1331 Pennsylvania Avenue, N.W.
Washington, D.C. 20004

Dear Mr. Jasinowski:

Thank you for your letter of October 7 to Secretary Brady regarding unitary tax and the Colgate-Palmolive case in California. It has been forwarded to me because it involves an issue of tax policy.

As a tax policy matter, we are equally opposed to the use of worldwide unitary apportionment to determine the income of domestic-parent multinational corporations and that of foreign-parent multinational corporations. The Treasury Department has testified before Congress that treaty-based limitations on unitary worldwide apportionment are "the least desirable of possible alternatives" (*i.e.*, state or federal legislation) precisely because they would benefit foreign-parent multinationals but not domestic-parent multinationals and thus not "satisfy the principle of ensuring competitive balance among similarly situated businesses." (*Cf.* Testimony of J. Roger Mentz, Treasury Assistant Secretary (Tax Policy), before the Subcommittee on Taxation and Debt Management of the Senate Finance Committee, September 29, 1986, page 3.) Our position has not changed.

Colgate-Palmolive filed a Petition for Review in the Supreme Court of California on September 30, 1991.



This Petition makes very effective use of Treasury's opposition to the use of worldwide unitary tax by the states, as expressed in Secretary Brady's letter of September 13 to Mr. Rueben Mark. Therefore, the Supreme Court of California is now well aware of our position, which has been clear and consistent. We see no reason at this point to submit a brief that would merely repeat the arguments made in the Petition.

Please be assured that we are following this litigation closely. We will coordinate with the Departments of Justice and State when it appears that further action is warranted.

Sincerely,

/s/ Kenneth W. Gideon
KENNETH W. GIDEON
Assistant Secretary
(Tax Policy)

[Attached to Colgate's Opening Brief on the Merits in the California Supreme Court]

MICHAEL GRYLLS, MP

[LOGO]

HOUSE OF COMMONS
London SWIA 0AA

23rd October 1991.

US Secretary Nicholas F. Brady,
Department of the Treasury,
1500 Pennsylvania Avenue, N.W.,
Washington DC 20220,
United States of America.

Dear Senator Brady:

As you know, I have been long concerned about the effect of the unitary taxation method employed by some states of the United States on the worldwide operations of multinational companies. This concern, shared by the overwhelming majority of my colleagues in the House of Commons, resulted in the retaliatory legislation of our 1985 Finance Bill. Although several states have changed their unitary tax policy for multinational companies, others have continued with the policy that is not in the best interests of international trade and investment. I know that this view is shared not only by the United Kingdom and the other non United States trading partners, but by the United States Administration itself.

My colleagues and I appreciate your continuing efforts in support of the Barclays Bank case which is challenging the constitutionality of the Californian tax in the Californian courts. There is an additional opportunity to limit the reach of this taxation method into international waters in the Colgate-Palmolive case also pending in the Californian courts. The Californian taxation method tends to distort trade flows because it implicates investment decisions well beyond the boundaries of the United States. Although the tax method has greater effect on foreign investments into the United States since United States companies do not face this unfair tax in the UK or in the other countries which are trading partners of the United States, concern arises also as to the effect on outbound investments. Measures which distort trade flows have been strongly criticised in the current GATT Uruguay round of negotiations, not the least by the United States.



For reasons outlined, I would strongly urge your department to intervene in the Colgate-Palmolive case by insuring that an amicus brief is filed before the time limit expires at the end of October so that the full international implications of the case can be brought to the attention of the California Supreme Court. I am sending a copy of this letter to the United States Department of Justice.

Yours Sincerely

/s/ Michael Grylls